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SIPDIS

DEPT FOR AF/S, AF/EPS, EB/IFD/OMA
TREASURY PLEASE PASS TO IMF AND WORLD BANK EXEC DIRECTORS

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TAGS: [EFIN](#) [ECON](#) [PGOV](#) [MI](#)

SUBJECT: IMF: SOME PROGRESS UNDERCUT BY FRESH PROBLEMS

REF: A. LILONGWE 240

[B](#). LILONGWE 179

[C](#). DILLARD/DAVIS EMAIL OF 3/10/2004

Classified By: Pol/Econoff Marc Dillard for reasons 1.5 b/d.

Summary

[1](#). (C) Malawi has made progress on its macroeconomic stabilization program, but it is unclear if that progress will be enough for the Executive Board to approve further disbursements, IMF Mission Chief to Malawi John Green told donors on March 23. Behind the scenes, an IMF staff member told Pol/Econoffs that the team's objective for its mission was to package a program that was a technically defensible way to disburse money without creating a precedent for exceptional disbursements to other countries. The GOM has made some structural progress as part of its program, but fresh revelations about poor elections budget implementation and improper grain handling pose significant threats to the GOM's agreement with the IMF. In upcoming meetings with IMF staff, we recommend USG officials probe for information on the program's sustainability and effectiveness in dealing with Malawi's biggest macroeconomic threat -- its burgeoning domestic debt. End summary.

Another Statistic-Free Outbrief by the IMF

[2](#). (SBU) IMF Mission Chief for Malawi John Green gave assembled donor Chiefs of Mission a ten-minute, nearly statistic-free outbrief about Malawi's Poverty Reduction and Growth Facility (PRGF) performance on March 23. Green stated that while the GOM's performance had not looked strong in November, he had good news: "nearly all" fiscal targets had been met for mid- to end-February, and the government is now focusing on its economic program. On structural conditions, Green stated that "many had been met, while some had not," and that "the team hopes it will be enough" for the program to go forward. He stated that the team would tell the Executive Board that there has been clear progress, and rhetorically asked and answered, "Will this be enough? I don't know."

[3](#). (SBU) Asked to elaborate, Green ran through structural criteria that had been due by end-December. Completed items included approval of a wage policy, completion of a public service pension scheme, and the hiring of a pay policy advisor (which was delayed, but had been accomplished March 22). Two wage policy conditions had not been met, but one (presumably the consolidation of civil service allowances into the GOM salary structure) was "too ambitious." (The other unmet condition appears to be the establishment of a public service remuneration board.) On the two contentious conditions that had been turned into prior actions, Green stated that the submission to Parliament of the "compromise" amendment to the Corrupt Practices Act (ref A) appeared to satisfy the prior action, and that the Anti-Corruption Bureau's (ACB) report on the National Food Reserve Agency (NFRA) was "almost done." (Note: Green chose his words carefully. While the GOM's actions on the Corrupt Practices Act do appear to satisfy the IMF's prior action language, they would not have satisfied the original second review condition.)

[4](#). (SBU) Green stated that the GOM "met almost all of its quantitative criteria for its September targets," although it had missed its net domestic assets target "by a small margin." Shifting to December targets, he stated that government borrowing "missed by a large margin," due mainly to delayed disbursements by donors, higher resulting interest payments on the domestic debt, and inaccurate IMF projections on interest rate reductions. "We have to mention" that GOM spending was higher than budgeted, he added, but so were revenues.

[5](#). (SBU) Green finished with the information that the IMF and GOM had established new targets under the supplementary budget, and that he was "pretty sure" that the fourth quarter would see net domestic debt repayment.

[6](#). (C) Green did not raise how the GOM would achieve domestic debt reduction in FY2004/05, which he had identified

in a March 15 donor inbrief as a critical issue. "The problem with next year," he said on March 15, "is that the numbers do not add up if the objective is debt repayment." Green then floated that there would be a gap of 3% of GDP between what donors are expected to give to Malawi and the resources required for meaningful debt reduction -- an estimate which he quickly backed off and qualified as speculative. Interestingly, Green refused during the donor inbrief to comment on the current size of more than MK 3 billion "statistical discrepancy" between expenditure and financing numbers the IMF had found in the GOM's early 2004 submission, saying that he had been "chastised" for revealing too much to donors. His closer holding of information about performance was matched by the GOM, which clearly cracked down on access to numbers during the visit. Even the Reserve Bank of Malawi's Director of Research and Statistics, usually a well-placed source on these discussions, was asked to leave discussions deemed sensitive. Only the senior-most management remained.

IMF Staff Member: "It's a political decision...."

17. (SBU) IMF Team Economist Cecilia Mongrut visited Pol/Econoffs on March 17 as part of the staff's efforts to forecast bilateral donor inflows over the next year and to look for the extra 3% of GDP (around \$60 million) loosely posited by Green as necessary for meaningful debt reduction. Mongrut arrived at the Embassy knowing that the USG does not give direct budgetary assistance to the GOM, but recalled that the Embassy had provided useful background and context on GOM actions and asked to use the meeting to discuss GOM structural performance, emerging rumors of improper handling of maize reserves, and overall economic trends.

18. (SBU) Pol/Econoffs briefed Mongrut, extensively covering observations about performance on the structural conditions and on prior actions, but also touching on the fiscal and monetary programs and on the real economy. In great detail, Emboffs discussed the importance of the ACB's report on NFRA performance, given the four similar reports on corruption in the maize sector that the GOM has buried during the past two years and their large, negative fiscal impact on the IMF program (ref C). Mongrut took notes on the various maize corruption cases, but offered little specific on GOM performance other than that, when bilateral disbursements did not appear in late-2003, the GOM did not cut its expenditures as required by its program. When domestic revenues went up, she stated that the GOM spent the unexpected monies instead of applying them to higher-than-expected interest charges.

19. (C) As the meeting wound down, Mongrut appeared tired of discussing program specifics and spoke more generally about Malawi. (Please strictly protect.) "We're working on the program up here," she said, pointing to an imaginary document, "but it comes down to a political decision here," and motioned underneath the hypothetical document. Presented with the Embassy view that Malawi needs aid to address poverty, but that the current cycle (contrived program targets, followed by missed, then relaxed criteria, with new, tougher, contrived targets proposed) has taught GOM officials to disregard program requirements and created a counter-productive long-term dynamic, she demurred. She explained that the team was looking for a way to craft a technical program that was defensible, because the IMF worries about its country-by-country treatment. "The point is," she concluded, "not to present a program that is an (humanitarian) exception, because other countries would then ask for exceptions, too," and she implied that the team had been tasked to find a way to make Malawi's program and its numbers work.

Recent Developments: Maize, Election Problems Surface

10. (SBU) As reported in ref A, the GOM successfully passed a supplementary budget during its March session along with the "compromise" amendment to the Corrupt Practices Act. Both actions appear to satisfy IMF prior actions. Work on the comprehensive audit of arrears continues, with more than twenty auditors reportedly working on ten ministries, but contacts at the EU (please protect) believe the audit will drag out longer than forecast and not be done before end-May. (Note: The auditors have reportedly asked for more time and resources, but it is not clear whether the request signals something about cooperation, the magnitude of arrears, or simply that the technical difficulty of the records search was underestimated.)

11. (SBU) Of greater concern, the Malawi Electoral Commission (MEC), with which the donors painstakingly put together an aid-supported elections budget in 2003, has announced that it cannot stick to its \$14.6 million allocation and requires an additional \$10 million (presumably from the donors) to carry out May's presidential and parliamentary elections. Upon investigation, it has become clear that (along with unbudgeted expenditures for an extended registration period) the MEC spent unbudgeted funds

on vehicles and that expensive allowances and "emoluments" that had been removed from the original budget have been re-inserted. When the MEC proposal to the donors got a chilly reception, it turned to the Treasury for more money, a request not factored into the supplementary budget.

112. (SBU) In another example, shortly before the IMF team arrived in Malawi, President Muluzi responded to constituent complaints about a lack of maize in some areas by announcing in a public rally that grain parastatal ADMARC depots would receive shipments within five days. The GOM subsequently distributed thousands of tons of maize from the Strategic Grain Reserve (SGR) and from commercial stocks outside of the channels that have been set up to avoid the maize corruption scandals of the past few years. This was in direct contravention of an agreement made by the GOM with the donors. At least 30,000 tons appear to have been taken out of the Strategic Grain Reserve, with another 40,000 tons taken from commercial stocks, all of which are being sold at the heavily subsidized price of MK 10 per kilo. This has led to an outcry in the donor community, and donor experts have not been satisfied with Ministry of Finance explanations of how the SGR will be replenished and how the stocks will be paid for. Information on the maize movements continues to surface, and the Embassy has no firm estimates of the costs. World Bank Country Manager Dunstan Wai told Pol/Econoff on April 1, however, that the IMF had discussed with the GOM shifting MK 1.4 billion (\$13 million) in associated expenses to the 2004/05 budget.

Comment

113. (C) Malawi's case is a difficult one. Delays and heavy pressure have sometimes resulted in relative performance improvements; some officials within the GOM are focusing on the economic program; and some progress on structural conditions has been made since November. (The IMF has given us too little to make an informed judgment about recent fiscal and monetary performance.) We continue to see, however, a lack of commitment to the program at senior political levels, and, as the Mission has documented, performance improvements have evaporated in the past as soon as it looks like funds will be disbursed -- which appears to be happening again. No one wants to get in the way of Malawi's third presidential and parliamentary elections, and the maize is already gone from its silos, leaving its magnitude-as-yet-unknown fiscal impact behind. Which leads us to the conclusion that new, fungible disbursements from the World Bank and Fund would most likely be applied to unbudgeted maize and election expenses, minimizing the disbursements' potential to move Malawi out of its debt spiral.

114. (C) Comment continued. We understand that the IMF staff will soon be briefing USG agencies in Washington on Malawi's recent performance. We would urge those meeting with staff to probe deeply on the program's sustainability and the likelihood that domestic debt will be reduced. With elections just weeks away, we believe that further information on those topics will be key to USG decision-making before Malawi's case comes before the Executive Board.

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